DISCUSSION OF DOMESTIC AND FOREIGN EXCHANGE RELATIONS

MR. JOHN PERRIN:

I should like to touch upon two points connected with the matter of internal exchanges, since they form the basis of the very strong objection on the part of country bankers to the acceptance of the provisions of this bill. That subject has been gone into here so thoroughly that I wish simply to raise two points that did not seem to be touched upon. In the discussion last week before the Economic Club in Boston, Mr. Samuel Untermyer made a statement that the profits of country national banks were seventy-two million dollars last year, of which about one-fourth came from exchange charges upon checks sent for collection and remitted. These charges, he said, constitute an unjust burden upon commerce. It is rather important to consider the exact ultimate result of such charges. I assume that the number of banks in the cities of the South and the West, and in sparsely settled districts generally, depends upon the profits which may be made in operating these banks. If they make one-fourth of their present profits from these exchange charges, then the result of doing away with the charges must be some liquidation of the banks, and less bank facilities for those sections that require them. At the present time those charges are absorbed largely either by city bank or city merchant. The ultimate consequences of the elimination, then, will be not simply the abolition of the charge which is now being paid by city banks and city merchants, but the lessening of bank facilities in country districts.

The other point was suggested in connection with the clear and searching paper presented by Mr. Talbert. In conversation with Mr. Butler, of the House banking and currency committee, I asked the question: "Is it to be understood that checks accepted for collection by the federal reserve bank are to be charged against the balances of the member bank?" He re-

plied, "I suppose so." How can a member bank in the interior know what checks are being charged against its balances? Each bank should have the right to take absolute control of its own balances. Under the proposed provision it would be required to carry a balance sufficient to meet unknown collection charges. Mr. Talbert's deduction that the plan would be impracticable is further emphasized by this point.

MR. W. C. FORD:

Under the methods of the Boston check clearing house a bank as close to New York as Stamford, or even closer, perhaps, is expected to clear through Boston. Does not that naturally come into the New York district?

MR. TALBERT:

Yes; during the investigation of the sub-committee of the clearing-house committee, on which sub-committee I had the honor of serving under Mr. James G. Cannon, among other things we looked carefully into the question as to what points should be free points. We came to the general conclusion that for the benefit of trade the New York banks could well afford to let in free any bank within twenty-four hours of New York or any bank from which returns could be received on the morning of the second day from the time we cash a check, provided always that they would remit New York funds without charge. So we should have made that recommendation but that a large number of the members of the New York clearing house were conservative men, well along in years, and opposed to radical changes. We could not get any other concession than to open up the New England territory and New Jersey, a good part of which is really suburban to New York. The Connecticut banks, having a greater need for New York than for Boston funds, wanted to come in, and bring to us forty millions of dollars that are now carried in Boston, Baltimore and Philadelphia. We gave them the option of coming in, but they have not come, because they cannot afford to. The small banks, in order to exist, must exact a reasonable toll to cover their own expenses in remitting. The Connecticut banks, however, made the proposal

that they would accept our terms on the condition that we would establish a bureau similar to that used in Boston, but we were not willing to do so. They offered to give us direct eight or nine cents a thousand, which they would have to pay through the clearing house anyway.

A MEMBER:

Now you are gradually moving to the point where every depositor in an American bank will be made to pay something for the privilege of keeping his account.

MR. TALBERT:

He certainly ought to. I picked up an example last winter. Ann Arbor has about five thousand students and probably almost half of them keep bank accounts. The banks charge all those students a moderate fee for keeping their accounts. The large banks in some cities estimate that it costs them a dollar a month to handle small accounts.

A MEMBER:

I do not understand Mr. Talbert's point concerning the value of the clearing system to commerce. You state that the Boston system is the most perfect yet developed, and that it has reduced the cost of collection to probably seven cents a thousand dollars. Nevertheless only 10% of the bank clearings go through by that method. Manifestly some other clearing method is more beneficial either to the banks or to the community.

MR. TALBERT:

It is more beneficial to the interior bank. The meat of the whole cocoanut is this—the actual final transportation of a certain amount of money is necessary for the maintenance of reserves. Also, there is a certain amount of expense in the way of clerk hire, postage, stationery, rent, salaries, and other unavoidable charges for conducting a business. The country banker is exposed to those charges quite as much as we are in the great places, and perhaps the charges are greater in proportion to the volume of his business. It is therefore necessary

for him to impose this small exchange charge. It is not very much on each transaction, but in the aggregate it amounts to an enormous sum. He is bound to impose that or suffer a loss. What advantage is it to his bank, he argues, that every customer of all the other banks of his town can have their checks circulated either in Boston or in New York? If they want to make a payment there, let them pay him ten or fifteen cents for a draft. Being deprived of that legitimate charge he takes it off the check, and commerce pays the charge, no matter how it comes in.

MR. J. H. MITCHELL:

I should like, if I am not out of order, to refer to Section 15 of the bill, which provides for open-market transactions. I have been informed that the object of that is to protect the gold reserve of the regional reserve banks; for that reason I think it is proper perhaps to bring the matter up at this time. The wording of this section gives the regional reserve bank the right to go into the open market and purchase bankers' bills, also to deal direct with farmers, corporations and individuals, and to purchase such bills as are eligible for rediscount. I should like to ask if, by this section, the reserve banks have the right to purchase commercial paper in the open market in competition with the member banks?

MR. GARDIN:

No; that relates solely to foreign transactions. I think it goes a little bit too far in permitting the federal reserve banks to go into the open market, because I do not think they can do it successfully. But such privilege is an absolute necessity in order to protect the gold supply. The member banks probably need it for their own purposes, as they would refuse to hand their paper over to the federal reserve bank unless at exorbitant rates. Therefore the federal reserve bank must have the right to make a bid itself. I think it is a wise provision, though from a selfish standpoint I should rather not see it in the bill. It will prevent any extortion on the part of the member banks in selling exchange to the federal reserve bank when it needs to am-

plify a foreign portfolio. Does that quite answer the question?

Mr. MITCHELL:

Not exactly. It certainly does not confine the transaction to foreign bills.

MR. GARDIN:

I think a previous section, however, provides that a reserve bank can give out paper only for its member banks; therefore it stands to reason that it cannot go out into the open market and buy domestic paper.

A MEMBER:

Mr. Mitchell, you have in mind, of course, what we term commercial paper in this country. Is that what you had in mind?

MR. MITCHELL:

Yes.

A MEMBER:

They could not purchase that. We have really no commercial paper in this country; we call notes on manufacturers' dealings commercial paper. The money borrowed may be used for commercial purposes, but I have known cases where it was used for building houses and doing other things of a permanent nature. They could not buy that kind of paper.

MR. MITCHELL:

That is what we hope it means, but does it?

A MEMBER:

Even if it did not, as Mr. Gardin points out, the federal reserve banks would not have the facilities for gaining credit information necessary to compete successfully with commercial banks in buying domestic paper; consequently they would prefer to buy paper that comes within the purview of the law. As Mr. Gardin says, it is absolutely essential that the reserve bank

for its own protection should be permitted to go out into the open market in competition with members and the private bankers. The regional banks could not control the gold movement merely by changing the discount rate; they would have to protect themselves by purchasing exchange in the open market.

MR. TALBERT:

The sense of that whole section, it seems to me, is that they can buy no paper of any kind, domestic or foreign, or at any rate, no domestic paper, without the endorsement of a member bank.

A MEMBER:

I had the same impression that Mr. Talbert has when I first read the section, but my attention was called to the fact that another construction was possible. I went to Mr. Glass, chairman of the banking and currency committee of the House, and asked the question: "Are the reserve banks under Section 15 permitted to buy commercial paper?" His reply was that that was the intention of the bill and that the purpose of the provision was to equalize and reduce rates. Section 15 is one of the most important sections af the bill and one that ought to be thoroughly understood. It should contain absolutely no ambiguity.

MR. STERN:

I desire to be enlightened about one important point of the bill. Acceptances, reserves and deposits are all interdependent, are they not? We have a section in the bill defining what reserve shall be held against deposits. Are the banks to hold reserves against acceptances, which are contingent liabilities?

PROFESSOR O. M. W. SPRAGUE, Harvard University:

The bill provides that the reserve shall be on outstanding demand liabilities. An acceptance is not a demand liability, but it matures in the future. No reserve is required against time liabilities.

MR. GARDIN:

An acceptance is an obligation of the bank's customer, and that is a protection. If the acceptance were made by the bank in order to borrow money, then it would be a different thing. Then, properly speaking, a reserve ought to be called for. But as it is a liability of the customer, his financial condition is closely inquired into before a bank gives its acceptance. Hence the possibility of any loss consequent upon this acceptance liability is so remote that it would be absurd to call for a reserve against it.

A MEMBER:

Must not the banks keep a reserve against deposits on certificates, though they are time liabilities?

PROFESSOR SPRAGUE:

The bill refers to the institutions to be established; they have no right to take time deposits. In speaking of the reserve of national banks it is necessary to use the term "deposits," but when speaking of the federal reserve banks the law very properly uses the expression "demand liabilities," since the federal reserve bank may not receive time deposits.

MR. F. B. WHITNEY, Waukegan, Ill.:

The United States has a favorable balance of trade exceeding a half billion dollars. Cotton and petroleum products, provisions and breadstuffs, copper and tobacco furnish half of our exports.

Foreign countries must buy these products from the United States; in fact, about three-fourths of our exports sell themselves and tend to control their own terms of sale and delivery; generally f. o. b. port export and cash against documents or rarely to exceed ninety days' payment. However, the marketing of the immense crops of cotton, wheat, corn and other staples often produces great anxiety in financial and business circles and sometimes causes such a tight money market that the government comes to the aid of the embarrassed bankers in the crop districts.

If the United States had one or more powerful foreign trade banks, they could aid materially in financing the movement of the crops from the field to the foreign buyer.

It is in the export of finished manufactures, however, that we most need the services of American branch banks abroad. England and now to an important extent Germany has rich trading concerns and banks with branches in every part of the world. In London alone there are nearly one hundred foreign and colonial banks. Hence England and Germany are masters of foreign credits, and herein lies one secret of their success in exporting finished manufactures in competition with the United States.

Europe will sell manufactures in foreign lands, c. i. f. import port, draft to be accepted upon arrival of the shipment in port, shipping documents to be delivered upon acceptance of draft and payment, to be made as necessary in either 60, 90, 120, 180, or 270 days after acceptance, depending upon the character of the goods and the import country. German banks through accounts current give personal credit to exporters who are allowed certain amounts of overdrafts from which they may pay cash to the German manufacturers. Both England and Germany with their innumerable foreign merchants and banks to give quick reliable information as to the daily standing of foreign buyers extend large open credits throughout the world. Probably the average credit based upon documents does not exceed ninety days, but whenever necessary credits are extended even to a year. The banks discount this long-time paper.

Probably drafts not exceeding ninety days will sell and finance the greater proportion of the United States' exports of finished manufactures; but we lose annually sales that aggregate immense sums because the United States has not seen fit to grant the longer credits given in Europe. This conservatism is at present inevitable; for the average United States export manufacturer has no available means to secure quickly proper trade information regarding the standing of prospective buyers. No great expansion of our exports of manufactures can be hoped for as long as we depend upon English and German banks to finance the marketing of them.

The federal reserve bill furnishes the discount facilities needed to extend foreign trade, but the benefits may be more apparent than real because New York will naturally try to continue her monopoly of the foreign exchange business. It might be prudent to insert in the act provisions that will permit any great section of the country to marshal its banking forces to protect its special interests abroad. The South might well be benefited by having a great "cotton" bank in England, and thereby cut out middleman commissions and eliminate certain abuses that injure the planter.

There are many ways to establish a great foreign trade bank or banks. Economically the ideal would be a system in which the federal reserve banks jointly owned a great foreign trade bank with branches throughout the world. Let the national local banks negotiate the exchange business in each district and then turn it over to the jointly owned reserve bank, which in turn could refer the business to the jointly owned foreign trade bank. This bank could face London with the accumulated power of the United States behind it. The federal reserve board can establish liberal regulations and modify them as experience dictates. Let the bank and the traveling man enter into foreign markets side by side; the result will gratify the American workman and manufacturer.